

Memorandum 2020-69

**Stock Cooperatives and Uniform TOD Security Registration Act:
(Discussion of Issues)**

In this study, the Commission¹ is developing a proposed law that could be used to make a nonprobate transfer on death of a decedent's ownership interest in a stock cooperative.

The ownership of an interest in a stock cooperative is based on the ownership of a share of stock. For that reason, the Commission has looked to the Uniform TOD Security Registration Act² as a possible model for the proposed law. That statute authorizes the registration of securities in transfer on death ("TOD") form. Securities registered in that form pass to a named beneficiary on the registering owner's death, without probate administration.

The Commission has also been using the revocable transfer on death ("RTODD") statute as a model. For many issues addressed by the RTODD statute, an interest in a stock cooperative is not materially different from any other interest in real property. On those issues, the Commission's and the Legislature's policy conclusions regarding the RTODD statute should be given weight in this study. This is especially true where the Legislature enacted a policy choice that is contrary to the Commission's recommendation. On those matters, the clear policy preference of the Legislature should be respected.

This study has been moving progressively through the issues that need to be addressed in developing the proposed law. **This memorandum discusses the mechanisms to be used for authentication of the registration instrument.**

1. Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

2. Prob. Code §§ 5500-5512.

BACKGROUND

A stock cooperative is an unusual form of common interest development (“CID”), because of the way that an individual interest in the development is held and evidenced. In most CIDs, the individual owners hold exclusive title to a dedicated part of the development (e.g., a unit, lot, or parcel) and a shared interest in common area.

In a stock cooperative, title is held entirely by a corporation that is formed for that purpose. Individual owners do not hold title to any part of the development. Instead, they have a use right. That use right is not evidenced by a deed, but by a share of stock in the corporation that owns the development. There may also be other documents that govern the use right (e.g., a membership agreement, occupancy agreement, or proprietary lease).

That is why the Commission recommended that stock cooperatives not be governed by the RTODD statute. That statute relies on a deed as the mechanism of transfer. It also relies on the system of public recordation and title insurance to validate the RTODD and the resulting transfer of title to a beneficiary named in the RTODD. Those mechanisms are unavailable to the owner of a stock cooperative, because the owner does not hold a deed.

REGISTRATION PROCESS

This study contemplates the use of a “registration” process as a way of establishing and validating a nonprobate transfer of a stock cooperative interest on death.

Registration is a common way to establish and validate a nonprobate transfer where there is a third party who holds the property for its owner or maintains an official record of title. In that situation, the TOD designation is “registered” with that third party, on a form provided and maintained by the third party. On receiving proof of the registered owner’s death, the third party is responsible for transferring ownership according to the terms of the TOD registration. Absent knowledge of a contrary claim to the property, the third party is not liable for making a transfer pursuant to the registration.

Examples include:

- *A pay on death account.* Financial institutions typically offer the option of designating a TOD beneficiary on the account agreement.

- *A vehicle or mobilehome.* On registering ownership of a vehicle or mobilehome, the owner may designate a TOD beneficiary.
- *Life insurance.* In exchange for the payment of premiums, the insurer agrees to pay benefits to a designated beneficiary on proof of the insured's death.
- *Retirement benefits.* A retirement plan may provide for death benefits, to be paid to a designated beneficiary on proof of the retiree's death.
- *Registered securities.* If ownership of a security is registered by the the issuing company, the company may offer the option of designating a TOD beneficiary as part of the registration.

Ownership of an interest in a stock cooperative has similar characteristics to the arrangements described above. The individual interest owner is issued a share of stock in the corporation that holds title to the development. As a condition of ownership, an owner enters into an agreement with the corporation, such as a membership or occupancy agreement. In effect, the stock cooperative holds property for the benefit of its shareholders and maintains records of who holds its shares.

Thus, it should be relatively straightforward to use registration to establish and validate a TOD designation in a stock cooperative. The owner would submit a TOD designation form to the stock cooperative to hold in its records. On proof of the owner's death, the stock cooperative would re-register the property in the name of the beneficiary. This would be similar to the re-registration of ownership that occurs under the Uniform TOD Securities Registration Act:

On death of a sole owner or the last to die of all multiple owners, ownership of securities registered in beneficiary form passes to the beneficiary or beneficiaries who survive all owners. On proof of death of all owners and compliance with any applicable requirements of the registering entity, a security registered in beneficiary form may be reregistered in the name of the beneficiary or beneficiaries who survive the death of all owners. ...³

AUTHENTICATION

The Commission has already provisionally decided that the proposed law should require the use of a simple statutory form when making a TOD designation in a stock cooperative.⁴ That would parallel the rule in the RTODD statute.⁵

3. Prob. Code § 5507.

4. See Minutes (Oct. 2020), p. 5.

5. Prob. Code § 5642.

The Commission has not yet decided what form of authentication should be required when executing a TOD designation or validating a transfer pursuant to the TOD designation.

The Uniform TOD Securities Registration Act is silent on that issue. The formalities of the registration process are left up to the registering entity.⁶

As enacted, the RTODD statute requires that an RTODD be signed, dated, and acknowledged before a notary public.⁷ In addition, the RTODD must be recorded in the county in which the property at issue is located, within 60 days of execution.⁸ Those requirements serve to authenticate an RTODD and pave the way to validate a transfer on the transferor's death.

In its follow-up study of the RTODD statute, the Commission recommended two further requirements.

First, the RTODD would need to be witnessed, using rules similar to those that govern wills. As the Commission explained:

Requiring that an RTODD be witnessed in the same way as a will would provide the following additional protections against fraud and undue influence:

- Two different witnesses would be required to be present when a transferor signs an RTODD. These witnesses could object and refuse to sign if the transferor appears to lack capacity or be under undue pressure. This should help to uncover and deter abuse of the RTODD.
- If one of the witnesses is a beneficiary, the RTODD would be presumed to be the product of fraud or undue influence.
- The witnesses would be competent to provide opinion testimony in any subsequent contest of the RTODD. This is important because a contest cannot be brought until after the transferor's death. At that time, the transferor would not be available to testify as to his or her own intentions, capacity, or freedom from undue influence. The witnesses could testify on those matters, having observed the transferor's condition when the RTODD was signed.

The protections afforded by witnessing are not perfect. A bad actor could use accomplices as witnesses in order to avoid genuine scrutiny. Nonetheless, witnessing would provide significant additional protection against fraud and undue influence.⁹

6. Prob. Code § 5510(a).

7. Prob. Code § 5624.

8. Prob. Code § 5626(a).

9. *Revocable Transfer on Death Deed: Follow-Up Study*, 46 Cal. L. Revision Comm'n Reports 135, 150-51 (2019) (footnotes omitted).

Second, before a beneficiary can acquire title pursuant to an RTODD, the beneficiary would be required to give notice to the transferor's heirs:

Under the Trust Law, when a trust becomes irrevocable because of the death of the trustor, the trustee must, among other things, provide written notice to the trustor's heirs. This alerts the heirs that the trust exists and will operate to dispose of the deceased trustor's property. If it appears that the trust is the product of fraud or undue influence, the heirs will have a timely opportunity to bring a contest.

The Commission recommends that the same general approach be applied to RTODDs. In order to take title to property transferred by RTODD, the beneficiary should be required to give notice to the deceased transferor's heirs. In addition, the beneficiary should also be required to record an affidavit affirming that the required notice has been given. Until the affidavit is recorded, the law would not protect the interest of a bona fide purchaser or encumbrancer of the property and the time limit for filing a fully effective contest would not commence. A beneficiary who fails to comply with the notice requirement, either intentionally or as a result of gross negligence, would be liable to heirs for any damages that result from the failure. Those requirements would alert those who have an interest in the deceased transferor's estate that the RTODD exists and is about to operate. This would give those persons a meaningful and timely opportunity to assess the validity of the RTODD and, if necessary, bring an action to contest it. If a contest is promptly filed, the contestant could also record a *lis pendens* to protect against a quick transfer of the property to a bona fide purchaser.¹⁰

The Commission could include similar requirements in the proposed law in this study. In other words, the proposed law could require that a stock cooperative TOD registration instrument be signed, notarized, witnessed, and recorded. It could also require notice to heirs before a transfer is completed.

However, there are three points that weigh against applying all of those requirements in the proposed law being developed in this study.

First, *we do not yet know whether the Legislature and Governor will agree that the RTODD statute should include the proposed witnessing and notice requirements.* If those requirements are rejected in that context, they should probably not be included in the stock cooperative statute. If an RTODD bill is introduced in 2021, its final fate could be known by October 2021. **If the Commission decides to include witnessing and notice requirements in the stock cooperative statute, it should probably hold off on finalizing its recommendation until after October. That**

10. *Id.* at 151-52 (footnotes omitted).

would allow for reconsideration of the decision if those requirements were rejected in the RTODD legislation.

Second, *stock cooperative ownership documents are not always recorded*. The staff has made inquiries into whether stock cooperative ownership documents are recorded and whether title insurance is a part of the conveyance of such an interest.

The answer seems to be that recordation of documents and title insurance are only used when an interest in a stock cooperative is purchased with lender financing. If a purchase is made with cash (which is reportedly common in limited equity housing cooperatives) or is donative (which would be the case with a transfer on death), documents are not typically recorded and title insurance is not obtained. This means that recordation and title insurance may be rare in some stock cooperatives (e.g., limited equity housing cooperatives) and intermittent in others (e.g., market rate cooperatives).

Those practices would seem to undermine the idea of relying on recordation and title insurance as a way of authenticating and validating a stock cooperative TOD registration. In many cases, title records would not provide a complete chain of title, which would make it difficult for title insurers to determine whether the person who executed the TOD registration has good title to convey.

Third, *when a registration process is used, there is another entity involved in the transaction, the registering entity. An agent of that entity can act to affirm the instrument's authenticity*. For example, in order to make a pay on death designation for a bank account, a form is completed and submitted to a bank official. Some form of acknowledging receipt is provided by the bank. A record of the designation is maintained and relied on by the bank. Similar processes are used when designating a TOD beneficiary for a vehicle or mobilehome registration, life insurance policy, retirement death benefit designation, and the like.

The same basic approach could be used in the proposed law. In order to register a stock cooperative interest in TOD form, the owner could be required to provide a signed registration form to an official of the stock cooperative. That official could be required to countersign and provide an official acknowledgment of receipt. The stock cooperative could also be required to maintain the registration in its official shareholder records.

That approach might be sufficient to authenticate and validate a stock cooperative TOD registration. The stock cooperative official's observation of the owner's signature and attestation to that fact would serve much the same purpose

as a witnessing requirement. The receipt of acknowledgment and retention of the form in the stock cooperative's records would substitute for recordation.

The staff believes that the involvement of an official third party in the registration process would provide an opportunity for authentication of a registration that does not exist when a person executes an RTODD. That important difference would seem to justify deviation from the approach taken in the RTODD statute.

Deviation from the RTODD approach is further justified by the fact that stock cooperative transfers are not routinely entered into county property records. Instead, the stock cooperative maintains and relies on its own membership records.

The staff recommends that the Commission use a registration approach of the type described above, for the purpose of a tentative recommendation in this study. In other words, the proposed law should require the following acts when an interest in a stock cooperative is registered in TOD form:

- (1) The owner must sign a completed statutory form in the presence of a stock cooperative official charged with accepting such forms for the stock cooperative.
- (2) The stock cooperative official must countersign, thereby attesting to having witnessed the owner's signature and officially received the form.
- (3) Both signatures should be acknowledged by a notary public.
- (4) The official should give the owner a copy of the executed form.
- (5) The stock cooperative should be required to maintain an official record of the form in its record of shareholders.

Witnessing and recordation requirements of the types used (or proposed for use) in the RTODD statute would not be included in the proposed law.

Does the Commission wish to take that approach?

Respectfully submitted,

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